Due service and receipt of a copy of the within is hereby admitted

this _____ day of November, 1938.

_____

Solicitor General of the United States

Counsel for Petitioner.

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1935

No. 304

RESPONDENT'S SUPPLEMENTARY BRIEF

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In the Supreme Court
OF THE
United States

October Term, 1938

No. 304

Guy T. Helvering, Commissioner of Internal Revenue,

Petitioner,

vs.

Chester N. Weaver Company (a corporation),

Respondent.

RESPONDENT'S SUPPLEMENTARY BRIEF.

PRELIMINARY STATEMENT.

Petitioner having failed to file its brief and serve the same on respondent's counsel within the time prescribed in paragraph 1 of Rule 27 of this Court and before the time necessary for respondent to forward its brief to the clerk of the above-entitled Court for filing within the time allowed by paragraph 3 of said Rule 27, this supplementary brief is presented.

The purpose of this supplementary brief is to reply to the contentions made by petitioner in its brief which was not received by respondent until November 5, 1938.

REPLY TO ARGUMENT.

In its preliminary draft of brief, received by respondent October 24, 1938, petitioner assumed the position that the statute under consideration is not ambiguous and resort to legislative history is unnecessary. Petitioner has now assumed a different attitude and has resorted to legislative history to support its position. This shift of attitude and its other changes of position require reply to those issues not presented or otherwise presented in petitioner's first preliminary draft.

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1. SECTION 23(r)(1) DOES NOT CONTROL SECTION 115(c) TO PREVENT THE DEDUCTION SOUGHT.

Petitioner asserts that, because section 115(c) provides that "amounts distributed in complete liquidation of a corporation shall be *treated as* in full payment *in exchange* for the stock" and, because, the distribution to respondent herein was in cash, therefore, there was a sale of the stock. By linguistic juggling it transfers "exchange" into "sale", and then claims that there was a "sale or exchange" within the contemplation of section 23(r)(1). To support this act of legerdemain, petitioner cites two cases interpreting the Revenue Act of 1918 (40 Stat. 1057, c. 18) and legislative history referring to the Revenue Act 1924 (43 Stat. 253, c. 234), both of which statutes were

long ago repealed and revised when the Revenue Act of 1932 (47 Stat. 169, c. 209) was adopted.

See:

Federal Income and Estate Tax Laws (Fifth Ed.), by Barton and Browning, showing comparison of sections of Revenue Acts of 1918 to 1932 inclusive.

Section 201(c)(2) of the Revenue Act of 1918 (40 Stat. 1057, c. 18), which the cases of *Hellmich v. Hellman*, 276 U. S. 233 and *Landstaff v. Lucas*, 9 Fed. (2d) 691, cited by petitioner, apply to a statute which was repealed by the Revenue Act of 1921. (42 Stat. 227, c. 136.)

The two cases cited above distinguish between "dividends" and "distributions" as described in section 201(a) and (c) of the Revenue Act of 1918. They make no reference to any other section of that Act and no duty was imposed on the Courts in those cases to define the words "sales or exchanges" or to use carefully refined language to describe the distinctions involved, nor did the Courts attempt to do so. Therefore, the decisions are not apt or applicable to the conflicts between the other portions of the 1918 Act, or to any subsequent Act. Moreover, the Revenue Act of 1918 did not contain the conflicting provisions which are to be found in the Revenue Act of 1932. In no way can the decision of this Court in *Moore Ice Cream Co. v. Rose*, 289 U. S. 373, 377, cited by petitioner, be applicable as law in this case.

The Revenue Act of 1921 repealed section 201(c) of the 1918 Act and contained no similar provision. In the 1924 Act a section numbered 201(c), but differing in language from section 201(c) of the 1918 Act, was enacted.

With reference to section 201(c) of the 1924 Act, petitioner cites a portion of the legislative history to support its contention (Brief, p. 11)—carefully omitting any reference to the legislative history of the 1928 Act which entirely changed the arrangement and application of the Revenue Act of 1926 (44 Stat. 2, c. 27) which repealed but followed the form of the 1924 Act. In considering the Revenue Act of 1932, the Act of 1928 is of great import.

The Revenue Act of 1926 created a "Joint Committee of the House and Senate on Internal Revenue Taxation" and charged it with the duty of preparing a bill for the simplification of taxes, particularly the income tax.

Revenue Act of 1926 (44 Stat. 2, c. 27), section 1203(a). The result of the work of this Committee was H. R. 1, 70th Congress, known as The Revenue Bill of 1928. In presenting this bill, the Ways and Means Committee of the House stated (Report 2, 70th Congress, 1st Session, pp. 11, 12):

> "The Committee is impressed with the importance of making *a fresh start.* • • •
>
> "Therefore, the provisions of the income tax title of the present bill apply *only to the taxable year 1927 and succeeding years* and have no effect whatsoever on taxes imposed for *prior taxable years.*" (Italics supplied.)

Following the above quotation the report gives an explanation of the rearrangement of the bill and the object thereof:

> "The bill embodies a proposed *new arrangement for the income tax title.* The basis for the arrangement is the distribution of the provisions by *two*

classifications: General Provisions and Supplemental provisions. • • •

"The General Provisions are those which apply to the *ordinary transactions of the ordinary classes of taxpayers.* It is believed that 80 per centum of the taxpayers who file returns under the new Act will find in the General Provisions practically all of the income tax statute law of interest to them. The General Provisions are divided into parts.

"The Supplemental Provisions *are those* which apply only to extraordinary classes of taxpayers or which apply *only to the extraordinary transactions of ordinary classes of taxpayers.* The Supplemental Provisions are divided into Supplements." (Italics supplied.)

lso, see, to same effect, Committee on Finance Report No. 960, 70th Congress, 1st Session, p. 18.)

In enacting the Revenue Act of 1928, Congress legislated Table of Contents, divided into titles, subtitles, parts nd su plements, with section headings. It also entitled ach section of the Act.

When the Revenue Bill of 1932, H. R. 123, was reported o the House, the Ways and Means Committee stated Report No. 708, 72nd Congress, 1st Session):

"The proposed bill follows the general plan of the Revenue Act of 1928. The proposed income tax title is made applicable to 1932 and subsequent taxable years."

When the Committee on Finance reported the bill to he Senate, it made exactly the same statement. (Report o. 665, 72nd Congress, 1st Session.) The bill became the

Revenue Act of 1932 under the foregoing legislative representations. Like the Act of 1928, the 1932 Act had included within its provisions a Table of Contents, divided into titles, subtitles, parts and supplements, with section headings. The 1932 Act, therefore, has its General Provisions intended for the ordinary transactions of ordinary classes of taxpayers and *its Supplemental Provisions applying "to the extraordinary transactions of ordinary classes of taxpayers"*, which included section 115(c). The dissolution of a corporation may not be classed as an "ordinary transaction".

In Part II of Subtitle B we find a provision for "Computation of Net Income" under the heading "General Provisions". Part II contains the section 23 upon which petitioner wholly relies to claim additional tax in this case by subordinating section 115(c) to section 23(r)(1). Petitioner ignores or obscures the fact that section 23(r)(1) can be applied only to the *"ordinary transactions of the ordinary classes of taxpayers"*.

In Supplement B we also find a provision for "Computation of Net Income" under "Subtitle C—Supplemental Provisions". Under this Supplement B we find the sections 111, 112 and 115 which petitioner desires to substitute for section 23. Supplement B is the independent and complete provision for computing the net income for *"extraordinary transactions of ordinary classes of taxpayers"*.

The *"distributions in liquidation"* of corporations provided for in section 115(c) cannot be considered as the *"ordinary transactions"* of a corporation but, because the section falls within Supplement B, they *must* be consid-

ered as the *"extraordinary transactions"* of corporations. Such transactions are far different than the "sales or exchanges" of stock by shareholders as contemplated by section 23(r)(1). Therefore, the net income of respondent as effected by section 115(c) must be computed under that section and sections 111 and 112.

It thus becomes apparent why and how the authorities and legislative history relied upon by petitioner and referred to above have no application to the case at bar.

Petitioner argues (Brief pp. 14-18) that the legislative history of section 23(r)(1) does not support our contention that it is not applicable and quotes in part from the Committee Reports. (Brief pp. 16 and 17.) Reading petitioner's quotations with those found in respondent's brief (Appendix B, pp. iv-vi), or reading the entire reports, will disclose that nowhere is there any expression of intent to apply the words "sales or exchanges" beyond their ordinary meaning. Also, it is clear that Congress did not indicate, even by the most obscure reference, any intent to interfere with the separate method of computation of net income in "distributions by corporations" found in section 115(c) under Supplement B of Subtitle C of the Revenue Act of 1932. To have made subsection 23(r)(1) applicable to subsection 115(c), Congress would have been required to amend section 115(c) or enlarge the language of section 23(r)(1) so that it could be applicable to section 115(c)—this Congress did not do.

2. **THE LONG ACCEPTED MEANING OF "SALES OR EXCHANGES" DEFEATS PETITIONER'S CONTENTIONS.**

The legislative history does not support the petitioner's contention that "the long accepted meaning of the words" sales or exchanges "used in section 23(r)(1) makes unavailable reference to the legislative history of that section". (Brief, p. 14.) The legislative history shows no inclination to enlarge the meaning of "sales and exchanges", such as petitioner seeks to do. To the contrary, the legislative history distinctly shows that those words were used to stop a common practice of minimizing taxes within the ordinary usage of the words "sales or exchanges". This Court has pronounced the rule which petitioner seeks to evade, viz.:

> "Unless the contrary appears, statutory words are presumed to be used in their ordinary and necessary sense, with the meaning commonly attributable to them."
>
> *DeGanay v. Lederer*, 250 U. S. 376, 381.

The words "sales or exchanges", as used in section 23(r)(1) had "no long accepted meaning", other than their ordinary meaning, when inserted in the statute. That section had never been interpreted by Court or regulation and has not to this day been interpreted in any way excepting in this case and in *Davis v. United States*, 87 Fed. (2d) 323, 325, where the constitutionality of the section was involved. In upholding the section on the challenge of its conflict with Article I, section 9 and the Fifth Amendment of the Federal Constitution, the Court did so upon the sole ground that section 23(r)(1) was aimed only at "probable speculative income and losses".

That decision did not contemplate the words "sales or exchanges" being used in the extraordinary sense sought by petitioner.

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3. PETITIONER'S CONSTRUCTION DOES INVOLVE A HARSH AND ABSURD RESULT.

Petitioner's assertion to the contrary (Brief p. 18) is not supported by the facts. Its position is absurd for the following reasons:

(a) It seeks to ignore the method of "Computation of Net Income" as provided for in Supplement B of Subtitle C of the Revenue Act of 1932 and erase sections 111, 112 and 115 from the Act in order to make section 23(r)(1) applicable.

(b) It seeks to interpret an ordinary and willing transaction, such as a sale or exchange, into an unwilling transaction, such as the distributions in liquidation of a corporation.

Its position is harsh because it seeks to transpose the language of section 23(r)(1) into something with a meaning beyond the words used by Congress, and to interpret an unusual, and in this case unfortunate, proceeding as a device to avoid taxes.

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4. THE LOSS IS DEDUCTIBLE UNDER SECTIONS 115(c), 111 AND 112.

Petitioner attacks the decision of the Court below on the ground that the loss is not deductible under sections 22(d). 115(c), 111 and 112. (Brief, p. 20.)

Heretofore, under title 1 of this argument, we have shown the independence of sections 111, 112 and 115 for the computation of net income for extraordinary transactions of an ordinary class of taxpayer. Section 22(d), which falls within Part II of Subtitle B—General Provisions for the computation of net income, provides the emphasis on the inapplicability of section 23(r)(1). That subsection definitely provides that the only way in which shareholders of a corporation may be taxed upon distributions by corporations. By subsection 22(d) Congress in passing the Revenue Acts of 1928 and 1932 issued an ultimatum which section 23(r)(1) does not overcome. One has but to turn to sections 112 and 115 in the subsequent Revenue Acts of 1934, 1936 and 1938 to observe that Congress has amended those sections to overcome the shortcomings of Supplement B of Subtitle C rather than amend Part II of Subtitle B to make the General Provisions apply.

CONCLUSION.

The majority decision of the Court below should be sustained.

Dated, San Francisco, California,
November 9, 1938.

Respectfully submitted.

ADOLPHUS E. GRAUPNER,
ARTHUR E. COOLEY,
Counsel for Respondent.

SUPREME COURT OF THE UNITED STATES.

No. 304.—October Term, 1938.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, vs. Chester N. Weaver Company.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

[December 5, 1938.]

Mr. Justice Stone delivered the opinion of the Court.

The question to be decided is whether payments received by a corporation as a stockholder in another corporation, upon the latter's complete liquidation, are to be treated as payments upon a sale or exchange of the stock under § 23(r) (1) of the Revenue Act of 1932, 47 Stat. 169, which allows the deduction of losses from sales or exchanges of stock, not held for more than two years, only to the extent of the gains from such sales or exchanges.

On August 9, 1932, respondent, a California corporation, purchased shares of stock in another corporation. In the following year the latter was completely liquidated. The liquidating dividends received by respondent amounted to less than the cost of the stock. In its income tax return for 1933 respondent deducted the full amount of the loss from gross income. The commissioner ruled that, since the loss was sustained upon an exchange of stock held less than two years and the respondent had received no gains against which the loss could be applied, the deduction was forbidden by § 23(r)(1), and he found a deficiency accordingly. The order of the Board of Tax Appeals sustaining the deficiency was reversed by the Court of Appeals for the Ninth Circuit, 97 F. (2d) 31. We granted certiorari, — U. S. —, to resolve the conflict between the decision of the court below and that of the Court of Claims in *White* v. *United States*, 21 Fed. Supp. 361, this day affirmed on certiorari in Nos. 96 and 97, *White* v. *United States*.

Section 23(f) provides that losses sustained by corporations during the taxable year shall be allowed as deductions in computing

net income, subject to the limitations provided in sub-section (r). Sub-section (r) (1) declares:

"Losses from sales or exchanges of stocks and bonds . . . which are not capital assets (as defined in section 101) shall be allowed only to the extent of the gains from such sales or exchanges . . . ." By § 101 "'Capital assets' means property held by the taxpayer for more than two years . . . ."

Since the loss sustained by respondent was not from the sale or exchange of the stock, it is contended that sub-section (r) has no application and that the loss is deductible in full, as are other losses, under § 23(f). Whether § 23(f) or 23(r) applies must be answered by deciding whether, under § 115(c), stockholders' losses upon a corporate liquidation are to be treated, for purposes of computation of the tax, in the same manner as losses upon a sale or exchange of the stock.

The scheme of the 1932 Act, as respects the treatment of gains and losses upon the sale or exchange of property on a different basis from other types of gain or loss, is substantially that of the 1928 Act, which we have considered in *White* v. *United States*, *supra*. The provisions of §§ 12(c), 22(d), (e), 23, 101, 111, 112, 113 and 115(c) of the 1928 Act, discussed in the *White* case, so far as now relevant were reenacted in the same numbered sections of the 1932 Act. The considerations which in that case led us to the conclusion that § 115(c) of the 1928 Act had placed stockholders' gains and losses from liquidations on the same basis as gains and losses from sales of the stock for purposes of computation of the tax, lead us to the same conclusion with respect to the 1932 Act.

We find nothing in the language or history of § 23(r) to suggest that Congress, in enacting it, had any purpose to restrict the operation of § 115(c) as we have construed it. Section 23(r), like § 101 in the 1932 and earlier Acts, speaks of losses resulting only from sales or exchanges. But the one does not more than the other restrict the operation of the provisions of §§ 115 and 112, which accord to losses on liquidation the same recognition accorded by § 23(r) to losses upon sales. Congress, in enacting the 1934 Act, recognized that under that of 1932 " . . . . a distribution in liquidation of a corporation is treated in the same manner as a sale of stock." Report of Senate Committee on Finance, No. 558, 73rd Cong., 2nd Sess., p. 37. To prevent avoidance of surtax through liquidation of corporations with large surpluses, Congress found it necessary to place gains on liquidations on a different basis from

gains on sales. It accomplished this by amending § 115(c) to provide: "Despite the provisions of section 117(a) [corresponding to § 101 in the earlier Acts specially taxing capital gains and losses] 100 per centum of the gain so recognized shall be taken into account in computing net income."

It follows that the extent to which the taxpayer can deduct the loss is controlled by § 23(r)(1), and that since the stock was held for less than two years and there were no gains against which the loss could be offset, it can not be deducted from gross income.

Reversed.

Mr. Justice McReynolds, Mr. Justice Butler and Mr. Justice Roberts dissent.

A true copy.

Test:

Clerk, Supreme Court, U. S.